Resp. Ex. 3.0

ILLINOIS COMMERCE COMMISSION

DOCKET NO.

DIRECT TESTIMONY

OF

JAMES C. BLESSING

SUBMITTED ON BEHALF OF

CENTRAL ILLINOIS LIGHT COMPANY
CENTRAL ILLINOIS PUBLIC SERVICE COMPANY
ILLINOIS POWER COMPANY

February 28, 2005

**DIRECT TESTIMONY**

**OF**

**JAMES C. BLESSING**

**CASE NO.**

**Q. Please state your name and business address.**

A. My name is James C. Blessing. My business address is 1901 Chouteau Avenue, St. Louis, Missouri 63103.

**Q. By whom are you employed and in what position?**

A. I am employed by Ameren Services Company ("Ameren Services") as Managing Supervisor, Power Supply Acquisition in the Strategic Initiatives Department.

**Q. Please describe your educational background, your work experience, and the duties of your position.**

A. My educational background consists of a Bachelor of Science degree in Electrical Engineering from the University of Missouri-Rolla in 1988 and a Masters in Business Administration degree from St. Louis University in 1998.

My work experience started as an Electrical Project Engineer for Southern Indiana Gas & Electric Company in October of 1988. In 1992, I accepted a position with the Power Generation Services Division of General Electric Company as a Field Engineer. In 1994, I left General Electric Company to accept a position with Union Electric Company as a Plant Engineer at the Labadie Power Plant. In 1999, I transferred to Ameren Services' Corporate Planning Department where I held the position of Consulting Planning Engineer. On January 1, 2004, I was promoted to the position Director of Resource Acquisition. On October 15,

2004, my position was transferred to the Strategic Initiatives Department and my title was changed to Managing Supervisor, Power Supply Acquisition.

The duties of my current position consist of procuring power supplies for Ameren Corporation's regulated utilities in Illinois and administering the contracts that result.

**Q. What is the purpose of your testimony in this proceeding?**

A. The purpose of my testimony is to describe the certain aspects of the competitive procurement auction ("CPA") that Ameren Corporation proposes to use to procure Basic Generation Service ("BGS") for its regulated utilities in Illinois: Central Illinois Light Company d/b/a AmerenCILCO, Central Illinois Public Service Company d/b/a AmerenCIPS (including the current AmerenUE-Illinois service territory upon completion of the transfer of this service territory to AmerenCIPS as discussed in the testimony of Mr. Craig Nelson) and Illinois Power Company d/b/a AmerenIP (collectively the "Ameren Companies" or the "Companies"). In addition, I will describe some of the key supplier contract terms and conditions that are at issue in the procurement process. First, I will discuss the detailed product design and then move on to certain aspects of the auction process.

## DESCRIPTION OF AMEREN'S PRODUCT DESIGN

**Q. What is the relevance of the Ameren Companies' service offerings to the CPA?**

A. In his direct testimony, Mr. Wilbon Cooper describes BGS, the generation service that the Ameren Companies propose to offer upon the expiration of the mandatory

transition period, on January 2, 2007. Because none of the Ameren Companies will own any significant generating resources, each company will need to procure power and energy sufficient to meet those service offerings. The auction process that the Ameren Companies are proposing is the process by which they will procure power and energy to supply this service. Thus, while I did not develop the post-2006 proposal, an understanding of that proposal is necessary to understand fully how the auction process will work, as well as the intent of the auction

**Q. What is BGS?**

A. BGS is the generation service that the Ameren Companies will procure in order to provide power to their regulated customers who choose not to take service from an Alternative Retail Electric Supplier ("ARES"). Since the utilities do not own generation, they will need to procure BGS (capacity and energy) from third parties.

**Q. Please provide an overview of the BGS product design that the Ameren Companies propose to procure.**

A. The Ameren Companies propose to procure three coordinated BGS products based on their combined load for two primary customer groups: (1) Residential and Small Business ("R&SB") (peak demand less that 1 MW); and (2) Large Commercial and Industrial ("LC&I") (peak demand 1 MW or greater). The LC&I load will be further divided into: (a) customers paying fixed prices for a one-year term; and (b) those paying prices based on real-time wholesale market prices. BGS will be procured separately for each of these three classes.

**Q. Why is the load divided into the two primary customer groups you described earlier?**

A. The reason for breaking the load into two primary customer groups is related to switching risk and the current state of the Illinois retail markets. The ability of individual customers to choose an ARES creates uncertainty for the BGS suppliers with respect to the magnitude of the load that the BGS suppliers will be required to serve. This switching risk is greater for larger customers, who have options available to them in the retail markets than for smaller customers (such as residential customers) whose options currently are limited.

In its product design, the Ameren Companies have taken two steps to mitigate this switching risk. First, the Companies will procure the supply separately for the two primary groups of customers. The supply for R&SB customers, whose switching risk is expected to be low, will be procured independent of that for LC&I customers, whose switching risk is expected to be much higher. This step places the cost premium associated with switching risk on the customer group that is creating the risk. Second, as discussed later in my testimony, LC&I customers taking fixed-priced service from the Companies must remain on this service for the entire term of the associated BGS supplier contracts (17 months for the first auction and one-year for all subsequent auctions). This will help to mitigate the risk premium associated with switching for this group of customers.

**Q. What type of products will the Companies be procuring for R&SB customers?**

A. For R&SB customers, the Companies will be procuring through the auction individual load shares (or "tranches") of fixed-priced, full requirements wholesale electric power supply that includes both capacity and energy. In addition, the suppliers will be financially responsible for the ancillary services, which will be procured by the Ameren Companies. This supply product will be called Basic Generation Service – Fixed Pricing ("BGS-FP"). Each tranche of BGS-FP supply will represent a fixed percentage of the BGS-FP load. To entice the greatest number of qualified suppliers, each tranche of BGS-FP supply will be sized to be approximately 100 MW of peak load. Each tranche represents an amount of load based on a fixed percentage of the total BGS-FP load. It does not represent individual customer loads or an aggregate of individual customers.

The full requirements BGS-FP product places certain risk, including price and volume risk, on the BGS suppliers. This allows the Ameren Companies to concentrate on what they do best (deliver energy to the end use customer and perform customer care functions) and allows the BGS suppliers to concentrate on what they do best (take on and manage all generation related responsibilities, including risk management).

In the first auction, the BGS-FP supply will be procured for three supply periods: the first for 17 months; the second for 29 months; and the third for 41 months, each representing one-third of the BGS-FP load. In each subsequent auction, the Companies will procure a single BGS-FP supply product for a 36-

month supply period for the one-third of the BGS-FP load for which the existing supply contracts are expiring.

**Q. Why are the Companies procuring BGS-FP supply for three different contract periods for this group of customers?**

A. In order to provide market-based yet reasonably stable pricing for this group of small customers, the Companies intend to procure overlapping three-year contracts in which one-third of the R&SB load is procured every year. While there may be variations in the market from year-to-year, overlapping three-year contracts will serve to stabilize or smooth out price fluctuation. This requires the procurement of BGS-FP supply for three separate contract periods in the first auction in order to step into the process. After the initial auction, the supply contracts for only one-third of the load will expire in any given year, and the Ameren Companies will, therefore, only be required to replace those expiring contracts. By replacing the expiring contracts with three-year contracts, the Ameren Companies ensure a continued three-year contract renewal cycle.

**Q. If the Companies intend to procure overlapping three-year contracts, then why are they procuring for 17, 29 and 41-month terms instead of 12, 24 and 36-month terms?**

A. The first auction will be for delivery beginning on January 1, 2007. The Midwest Independent Transmission System Operator, Inc. ("MISO") planning year starts on June 1 of each year and ends on May 31 of the following year. The 17, 29, and 41-month contracts that the Ameren Companies intend to procure in its first auction will end on May 31 of 2008, 2009, and 2010, respectively. This approach

allows the Ameren Companies' procurement schedule to align with the MISO planning year. Of course, after the first auction, the replacement contracts with three-year terms will precisely coincide with the MISO planning year.

**Q. Why is it important for the Ameren Companies' competitive procurement schedule to be in line with the MISO planning year?**

A. It is important for the competitive procurement schedule to be in line with the MISO planning year because this will simplify the nomination and acquisition of Financial Transmission Rights ("FTRs") by the winning bidders in the auction. FTRs are financial instruments that allow the suppliers to hedge the transmission congestion risk associated with serving BGS-FP load. Aligning the Ameren Companies' competitive procurement process with the MISO planning year allows suppliers to nominate and receive FTRs directly from the MISO. This will provide each supplier with the opportunity to hedge its congestion risk using the portfolio of FTRs it acquires from the MISO. The suppliers' ability to nominate and receive FTRs directly from the MISO is expected to result in a lower price for the end use customer.

**Q. How does the Companies' product design for this customer group compare to the New Jersey product design for similar customers?**

A. The product design for R&SB customers used in the New Jersey process is fundamentally the same. The product in New Jersey is a full requirements product and is procured using rolling three-year contracts. Two differences between the Companies' products and those in New Jersey are (1) the breakpoint between small customers and large customers is different and (2) the suppliers in

New Jersey are responsible for procuring Network Integration Transmission Service ("NITS") and ancillary services along with capacity and energy. Other than these differences, the product design is fundamentally the same.

**Q. What type of products will the Companies be procuring for LC&I customers?**

A. For LC&I customers, the Companies will be procuring two separate products -- a fixed-price product and a variable energy price product.

The first product is a fixed-price, full requirements product that includes a single fixed price for capacity and energy. In addition, the suppliers will be financially responsible for the ancillary services, which will be procured by the Companies. This product will be called Basic Generation Service – Large Customer Fixed Pricing ("BGS-LFP"). In the first auction, 100% of the BGS-LFP supply will be procured for a 17-month term. In subsequent auctions, the BGS-LFP supply will be procured for 12-month terms.

The second product will be a full requirements product that includes a fixed price for capacity and an energy price that varies on an hourly basis. Again, the suppliers of this product will be financially responsible for the ancillary services, which will be procured by the Companies. This product will be called Basic Generation Service – Large Service Real-Time Pricing ("BGS-LRTP"). In the first auction, the BGS-LRTP supply will be procured for a 17-month term. In subsequent auctions, the BGS-LRTP supply will be procured for 12-month terms.

**Q. Why are the Companies procuring two products for the LC&I Customers?**

A. By way of background and for discussion purposes, in New Jersey the distribution companies only procure a real-time price product for customers greater than 1,250 kW. A New Jersey customer within this classification, therefore, has two power supply choices: (1) a third party supplier; or (2) the distribution company's real-time price product.

We recognize that, due to the current level of development of retail competition in middle and southern Illinois, the competitive options for some customer groups may be limited. For this reason, the Companies have chosen for the current time to provide a fixed-priced option for these customer groups.

**Q. Which of these two products will be the default product for LC&I customers?**

A. LC&I customers will default to BGS-LRTP unless they elect to take the BGS-LFP supply product and commit to remain on that service for the full term of the product (i.e., 17 months for the first auction and one year for all subsequent auctions). LC&I customers will have a 30-day open enrollment period in which they can sign up for the BGS-LFP supply. The 30-day enrollment period will being on the first business day following the filing of the Market Value Informational Filing by the Ameren Companies. Those customers who do not sign up during the open enrollment period will be placed on BGS-LRTP supply until such time as they choose an ARES. These customers will not be eligible to sign up for BGS-LFP supply until the next open enrollment period.

**Q. You mentioned a 30-day open enrollment period. Does the open enrollment period create additional risk to the supplier?**

A. There might be additional risk for the supplier. It is my belief, however, that this approach will provide a lower overall auction price for this product. To understand why I believe that this approach yields a lower overall price, you must look at the alternative.

The alternative is to design the BGS-LFP product to be similar to the BGS-FP product where customers can switch to or from the fixed-priced product at any time during the year. One would expect that this approach would result in a larger risk premium to address switching volatility throughout the term compared to the open enrollment period approach, in which switching risk is limited to the 30-day open enrollment period. In essence, the risk that the supplier takes on by holding the price open during the open enrollment period is more than offset by the fact that, at the end of the enrollment period, the supplier will know the magnitude of the load for which it will be responsible. In other words, at the end of the open enrollment period the supplier faces no switching risk.

**Q. Will the Companies be procuring the BGS-LFP product in "tranches", similar to the BGS-FP product?**

A. Yes, the BGS-LFP supply will be bid out in tranches with each tranche representing a fixed percentage of the BGS-LFP load. Like the BGS-FP product, the tranches of BGS-LFP supply will be sized to be approximately 100 MW of peak load to allow the greatest number of qualified suppliers. Again, the BGS-LFP tranche represents an amount of load based on a fixed percentage of the total

BGS-LFP load; it does not represent individual customer loads or the aggregate of individual customers.

**Q. Why are the Companies procuring only a single 17-month term, fixed-priced product for the LC&I customers while procuring three fixed-priced products of 17, 29 and 41-month terms for the R&SB customers?**

A. In the first auction, the BGS-LFP product is being procured for 17 months to align the procurement schedule with the MISO planning year. In each subsequent auction this product will be procured for a 12-month term.

The annual fixed-price contracts for these LC&I customers provide the stable, market-based rates that may be compared with offers from other ARES. These customers, as I indicated above, have or will have other suppliers interested in serving their load, among other options. They will have the benefit of deciding if the fixed, one-year BGS-LFP product is suitable for their needs in comparison to other offers in the market, whether the other offers are for one year or multiple years.

**Q. What competitive procurement mechanism will the Companies utilize to procure these products?**

A. As discussed in detail in the testimony of Dr. Chantale LaCasse of NERA, the Companies will utilize a Simultaneous, Multiple Round, Descending Clock Auction similar to the one used by the New Jersey electric distribution companies to acquire BGS supply each year since 2002.

## SUPPLIER CONTRACTS

**Q. Please provide an overview of the supplier contracts that the Ameren Companies will enter into.**

A. Accompanying my testimony are the three standard supplier contracts: (1) the BGS-FP Supplier Forward Contract (Resp. Ex. 3.1), (2) the BGS-LFP Supplier Forward Contract (Resp. Ex. 3.2) and (3) the BGS-LRTP Supplier Forward Contract (Resp. Ex. 3.3). These standard contracts define in detail the terms pursuant to which each auction product will be procured by the Ameren Companies in the first BGS auction.

The BGS-FP Supplier Forward Contract lays out the detailed contract terms for the fixed-priced, full requirements product that the Ameren Companies will procure to supply their R&SB customers. Those registered bidders who win tranches of BGS-FP supply in the auction will be required to sign this contract following the close of the auction.

The BGS-LFP Supplier Forward Contract lays out the detailed contract terms for the fixed-priced, full requirements product that the Ameren Companies will procure to supply their LC&I customers who choose to take service under Rider BGS-L. Those registered bidders who win tranches of BGS-LFP supply in the auction will be required to sign this contract following the close of the auction.

The BGS-LRTP Supplier Forward Contract lays out the detailed contract terms for the real-time priced, full requirements product that the Ameren Companies will procure to supply their LC&I customers, who choose to take

service under Rider RTP-L. Those registered bidders who win tranches of BGS-LRTP supply in the auction will also be required to sign this contract following the close of the auction.

**Q. Why is it important that the terms of the standard contracts be clearly defined prior to the auction?**

A. The contracts are referred to as standard contracts because each supplier who wins load for a specific product will be required to sign virtually the same supplier contract (only the supplier name and number of tranches will differ from contract to contract). The terms of these contracts will be finalized prior to the start of the auction. There will be no individual negotiations with respect to these contracts. The use of standard contracts is essential to the auction process because it adds to the transparency of the process and increases the participation in the auction. Because all suppliers are registered using the same standard qualification requirements, and all contract terms are known before the start of the auction, bids can be compared purely on price. This approach results in an extremely transparent bid evaluation process that makes the auction more attractive to a wide range of potential suppliers.

**Q. How did the Companies develop these standard contracts?**

A. We developed these supplier forward contracts using the New Jersey Supplier Master Agreements as the starting point. We recognize that the supplier contracts are integral components of a successful auction. By starting with the New Jersey contracts and changing only those terms that are required to make the process

work in the Ameren Companies' service territories, we can build on the successes already obtained in the New Jersey auctions.

**Q. What terms have changed from the New Jersey contracts?**

A. As stated in the previous question, the changes that were made to the New Jersey contracts were made to make the process work in the current market and regulatory environments in Central and Southern Illinois. The following major modifications were made.

First, the Ameren Companies will have three forms of standard contracts based on their product design. In New Jersey, only two products are procured in auctions.

Second, the New Jersey contracts were modified to reflect the fact that the Ameren Companies will remain the Load Serving Entities ("LSEs") for the load and, therefore, will be responsible for the procurement of NITS and ancillary services. As discussed in the direct testimony of Mr. Nelson, the Ameren Companies have chosen to remain the LSE to make it clear that the transaction between the BGS suppliers and the Companies are wholesale transactions and also to reflect that the Ameren Companies continue to have the provider of last resort responsibility. By having the utilities responsible for the procurement of NITS, it makes it clear that the suppliers are not responsible for changes in network transmission services prices. In addition, the utilities will be responsible for the procurement of ancillary services from the MISO via the MISO Open Access Transmission Tariff ("OATT"). The costs of such ancillary services will

then be passed on to the suppliers, who can embed them into their fixed-price offers.

Third, the New Jersey contracts were modified to reflect a different delivery point. In New Jersey, the delivery point is at each utility's PJM meters while the title change takes place at the retail meter. In the Ameren Companies' standard BGS contracts, the delivery point is defined as the specific load zones recognized by the MISO as encompassing the BGS load for which the specific BGS supplier is responsible. The MISO's current market rules do not allow the definition of a load zone that spans multiple control areas. Therefore, the winning suppliers in the Ameren Companies' BGS auction will deliver to three load zones, one for the AmerenCIPS portion of the BGS load, one for the AmerenCILCO portion, and one for the AmerenIP portion. The title transfer will be at the delivery point.

Fourth, the Companies' standard BGS contracts include specific language related to PURPA Qualifying Facility ("QF") generation. Specifically, the contracts clearly state that the QF generation will be treated as negative load that will be considered as an offset to BGS-LRTP load. There is no similar language in the New Jersey contracts.

Fifth, the New Jersey contracts were modified to reflect necessary changes to the treatment of FTRs and Auction Revenue Rights ("ARRs"). FTRs and ARRs are financial instruments that allow MISO market participants to hedge the congestion risk associated with delivering energy to the load. The MISO currently allocates FTRs and ARRs to LSEs annually based on the MISO's

planning year which begins on June 1 of a given year and ends on May 31 of the following year. This creates two issues that need to be addressed in the standard BGS contract: (1) the re-allocation to the winning suppliers of the FTRs/ARRs that will be allocated to the Ameren Companies for the January 1, 2007, through May 31, 2007, time period; and (2) transferring the Ameren Companies' right to directly nominate and receive FTRs/ARRs to the winning suppliers for the MISO planning period beginning June 1, 2007 and all future MISO planning periods. The Ameren Companies' standard BGS contracts define how the FTRs/ARRs will be re-allocated from the Ameren Companies to the winning suppliers for January 1, 2007, through May 31, 2007, time period and how the right to nominate and receive FTRs/ARRs will be transferred to the winning suppliers on an ongoing basis.

Sixth, the New Jersey contracts contain specific language related to load caps. This language was not included in our contracts because we consider load caps to be an auction design issue. These standard contracts will not be in effect until after the auction is complete at which point load caps are no longer relevant.

Seventh, the Ameren Companies' standard BGS contracts contain slightly different tranche terms than what is contained in the New Jersey contracts. The reason for our use of slightly different tranche terms was explained in detail earlier in my testimony when I was discussing the product design. Restated briefly, our tranche terms are different in order for the Ameren Companies to step into a process where rolling three-year contracts are used to supply the BGS-FP load and to allow the CPA to synchronize with the MISO planning year.

Eighth, in our standard contracts, the supplier generally is responsible for all taxes owing before receipt at the delivery point and the Ameren Companies are responsible for taxes owing after receipt at the delivery point. In New Jersey, the winning suppliers are responsible for all federal, state, municipal, and other taxes. The reason for this change is due to the change in the title transfer point.

Ninth, the credit provisions in our standard BGS contracts are fundamentally the same as in the New Jersey contract, with the exception that the Independent Credit Requirement ("ICR") was eliminated and the Credit Limit Caps were modified. The reasons for these changes are discussed in detail in the direct testimony of Mr. Roger Fetter.

Tenth, the contract language was modified to make it clear that our standard BGS contracts are forward contracts. This included, primarily, adding provisions stating clearly that the agreement is a "Forward Contract" and that each party is a "Forward Contract Merchant", as those terms are defined under the U.S. Bankruptcy Code. These changes are designed to provide assurances that the Ameren Companies can terminate a standard BGS contract if a supplier files for bankruptcy protection.

Finally, there were various minor changes to the contract language to reflect differences in terminology between New Jersey and Illinois. These include things such as replacing "EDC" (Electric Distribution Company) with "the companies", and "Third Party Supplier" with "Retail Electric Supplier" among others.

**Q. Have any potential suppliers had an opportunity to provide input into the development of these contracts?**

A. Yes, they have. On December 17, 2004, the Ameren Companies and Commonwealth Edison Company hosted a meeting with interested suppliers to discuss the specific terms of each company's standard BGS supplier contract for their below 1 MW customers. At the end of the meeting copies of the contracts were distributed to the suppliers, who were the given the opportunity to submit questions and comments to the companies. A second meeting with the suppliers took place on January 14, 2005, in which the companies provided responses to the questions and comments submitted by the suppliers. We utilized the feedback received from these supplier meetings in drafting the standard BGS contracts included in this filing.

**CONTINGENCY PLANS**

**Q. What is a contingency plan?**

A. Contingency plans define the process that the Ameren Companies will use to procure replacement supply in the unlikely event that additional supply sources are required beyond what is procured in the Ameren Companies' BGS auctions. While not every contingency can be anticipated, we have identified three possible scenarios for which a contingency plan would be required: (1) the Ameren Companies receive an insufficient number of bids to provide for a fully subscribed auction volume for one or more of the products being procured in a BGS auction; (2) supplier default prior to or during the delivery period of a BGS

supplier contract; and (3) the Illinois Commerce Commission ("Commission" or "ICC") rejects the results of a BGS auction.

**Q. Please describe the circumstances which would lead to an auction not being fully subscribed.**

A. In order for the auction process to achieve the best price for customers, the level of competition in the auction must be sufficient. To ensure a sufficient level of competition, the Auction Manager has the option to reduce the auction volume. The process that the Auction Manager will use when deciding to reduce the auction volume is discussed in the direct testimony of Dr. LaCasse.

**Q. Please describe the contingency plan for a less than fully subscribed auction volume.**

A. In the event that the auction volume fails to procure 100% of a BGS auction product, we will purchase the necessary services for the unfilled tranches of BGS supply through the MISO-administered spot markets until the next scheduled BGS auction. The remaining term of the unfilled tranches of BGS supply would be included in the next scheduled BGS auction. To the extent that the MISO has not yet implemented a market for capacity, the Ameren Companies will procure the required capacity through the bilateral capacity markets.

**Q. Why do the Companies believe it is appropriate to purchase replacement supplies for this contingency from the MISO-administered spot markets?**

A. The Companies believe that purchasing replacement supplies from the MISO-administered spot markets is appropriate because it will alert bidders that in order to secure BGS supply prices from the Ameren Companies, it will be necessary to

bid in the auction. Purchasing BGS supply in the MISO-administered markets is a strong feature of the auction proposal because it provides bidders a strong incentive to participate in the auction process. Bidders would have a diminished incentive to participate in the auction and present their best offers if they believed that a less than fully subscribed auction would lead to a negotiation or a secondary market in which the Companies, on behalf of their customers, would seek to acquire fixed-priced supplies.

**Q. How would the Ameren Companies procure power in the unlikely event that one of its BGS suppliers defaults?**

A. To protect customers against (however unlikely) cases in which a supplier defaults on its obligation after bids have been awarded, the Companies propose the following contingency plan:

- Immediately upon default-related termination of the supply contract, the Companies would replace the defaulted-on supply obligation through purchases from the MISO-administered spot markets as a stop-gap (temporary) mechanism. To the extent that the MISO has not yet implemented a market for capacity, the Companies will procure the required capacity through the bilateral capacity markets.

- If the default occurs less than 90 days before the end of the defaulted-on contract's last delivery day, the Companies will continue to replace the contract's supply obligation through MISO spot market purchases for the remaining delivery period of the defaulted-on contract.

- If the default occurs 90 or more days before the end of the contract's last delivery day, the Companies immediately will issue a request for proposal ("RFP") to replace the remaining term of defaulted-on BGS tranches through a power purchase agreement ("PPA") with deliveries starting 20 days after termination of the defaulted-on contract's supply obligation. The RFP would be sent to all registered bidders from the most recently completed BGS auction. Winners in the RFP would be required to sign the same BGS Supplier Forward Contract with the only modifications being the term and price. Until delivery is taken under the replacement supplier contract, the contract's supply obligation will be replaced through the MISO-administered spot market purchases.

- Any incremental costs or savings associated with prudently-procured replacement power purchases would be collected from the defaulted BGS supplier. To the extent that some portion of the incremental cost in unable to be collected from the defaulted BGS supplier, this cost would be trued up through a market value adjustment factor explained by Mr. Robert Mill in his direct testimony.

**Q. Why do the Companies believe that this is an appropriate contingency plan in the case of supplier default?**

A. The Companies' contingency plan for supplier default is appropriate because it: (1) maintains a continuous supply of the full requirements product required to serve the load; and (2) allows the Ameren Companies to quickly identify the full replacement cost of the defaulted supply contract. Identifying the replacement cost quickly will enable the Companies to settle with the defaulting supplier as soon as reasonably as possible.

**Q. What contingency plan do the Companies propose in the unlikely scenario that the Commission rejects the results of a BGS auction?**

A. Should the Commission reject the results of a BGS auction, the Companies would meet with the ICC Staff, the Auction Manager and Auction Advisor within five days and review the reasons why the Commission rejected the results.

If the auction results were rejected for reasons that could easily be corrected (e.g., some flaw in the auction process, the behavior of a particular supplier, etc.) then the appropriate corrections would be made and it is expected the Auction Manager would re-run the auction .

If the auction results were rejected for reasons that are not easily corrected, the Companies would work with the ICC Staff to develop an alternative procurement plan to be used to procure the required BGS supply until the next

scheduled BGS auction. The Ameren Companies would file the plan with the Commission for approval. The unfilled tranches of BGS supply would be included in the next scheduled BGS auction.

**Q. Why do the Companies believe that this is an appropriate contingency plan in the case where the Commission rejects the results of a BGS auction?**

A. We believe that this is an appropriate contingency plan in the case where the Commission rejects the results of a BGS auction because it allows the utilities and the ICC Staff the appropriate level of flexibility to evaluate the reason for the Commission rejection and take the appropriate action. The reasons for complete Commission rejection of a BGS auction can vary widely and attempting today to determine a precise alternative procurement plan that is appropriate for all possible scenarios simply does not make sense.

## COMPETITIVE WHOLESALE MARKETS AND HOW MARKET PARTICIPANTS WILL ASSEMBLE BIDS

**Q. What is the role of the MISO in the auction process?**

A. Although the MISO does not have a direct role in the auction process, the existence of the MISO day-ahead and real-time markets is important to the success of the auction or any other competitive procurement process. These markets are the foundation of the wholesale market from which the pool of potential suppliers will assemble the products that they will bid. The expected level of prices in the day-ahead and real-time markets will set the value of the standard wholesale products (e.g., 5x16 Energy, 7x24 Energy, Off-Peak Energy, etc.) in the general marketplace. These markets also provide potential bidders with the ability to purchase energy on an hourly basis to convert the standard

products available in the market into the full requirements, load following products up for bid in the auction.

**Q. How will potential suppliers assemble the auction products that they will bid into the CPA?**

A. There are various ways in which a potential supplier could assemble the capacity and energy products needed to participate in the auction. I will discuss two such ways: (1) assembling the auction product from a portfolio of physical generating assets; (2) assembling a portfolio of readily available energy and capacity products. A potential supplier could also use a combination of these two.

**Q. Please describe how a potential supplier would participate in the auction utilizing a portfolio of owned or controlled generating assets to serve a tranche of load?**

A. A potential supplier who owns or controls a portfolio of generating assets could participate directly in the auction utilizing the uncommitted portions of these facilities to supply the capacity and energy requirements of the BGS supply contract.

An owner of generating assets also may choose to participate in the auction indirectly. In this scenario, the supplier could sell the output of its generating assets to a third party who then could participate in the auction directly. This approach might make sense for a supplier who only owns peaking generation, for example.

**Q. Do the generating assets need to be located within the footprint of the Ameren Illinois service territories?**

A. No, they do not. The generating units can be located outside the Ameren-Illinois footprint as long as they meet certain requirements set by the MISO. These requirements are the same for MISO generators located inside or outside of the Ameren-Illinois service areas. For all generators located within the MISO footprint, the generators would have to be considered deliverable to the Ameren-Illinois Load Zones as determined by the MISO deliverability test. The deliverability to the Ameren-Illinois Load Zone for every generator within the MISO footprint will be known prior to the start of the auction. Deliverability is discussed further in the testimony of Mr. Robert McNamara of MISO.

For generating assets located outside the MISO footprint, the supplier would be required to have a firm transmission path to the MISO border and the generator would have to be considered by the MISO to be deliverable to the Ameren-Illinois Load Zone. It is unlikely that the deliverability of generating units outside the MISO footprint would be known prior to the auction.

**Q. Please describe how a financial participant would participate in the auction?**

A. The ability of a financial participant, a market participant who does not own generating assets in the region, to supply the auction products is premised on the existence of physical and financial markets operated by the MISO. The foundation of the MISO markets is the day-ahead and real-time energy markets. As discussed in the direct testimony of Mr. McNamara, the MISO day-ahead and real-time energy markets are scheduled to startup on April 1, 2005. These

markets will produce the transparent spot-market energy prices that act as the foundation of the longer-term wholesale energy markets. Layered on top of these transparent spot markets are a host of financial products for energy at various trading hubs that allow these financial participants to hedge the risk associated with supplying these fixed-priced, full requirements products. A financial participant could also enter into a bilateral agreement with an asset owner to hedge its supply risk.

**Q. The MISO does not yet operate markets for capacity or ancillary services. Would that prevent financial participants from bidding into the auction?**

A. No. While the existence of RTO-operated capacity and ancillary services markets do improve the market structure that supports these auctions, they are not necessary to hold an auction because avenues currently exist for financial participants to procure each of these products required to assemble the auction products. Capacity can be procured through bilateral markets and there is more than sufficient physical assets currently installed in and around the state of Illinois and the MISO footprint to supply this capacity. And as stated earlier in my testimony, ancillary services will be procured by the Companies.

**Q. Does the MISO currently have plans to operate capacity and ancillary services markets in the MISO footprint?**

A. Yes, it does. As discussed in detail in the direct testimony of Mr. McNamara, the MISO currently projects to have capacity markets up and running in 2006 and ancillary services markets up and running in 2007. Once up and running, these MISO-administered capacity and ancillary services markets will increase the price

transparency for these products, which should further increase the efficiency of the auction process.

**Q. How would a financial participant use these financial markets to assemble the CPA products?**

A. A financial participant who wishes to participate in the auction will utilize the day-ahead and real-time spot markets operated by the MISO to physically deliver the energy associated with a full requirements tranche of load. They also might purchase a combination of on-peak, off-peak, and around the clock energy products from a liquidly traded trading hub in order to mitigate the risk associated with delivering from the spot market.

In addition, in the near term, the financial participant will purchase capacity via the bilateral markets to complete the assembly of the auction product. Later, the financial participant might purchase capacity via the MISO markets.

**Q. If there is not a liquid trading hub for energy products delivered to the Ameren-Illinois footprint, will this prevent the financial participants from participating in the CPA?**

A. No, financial participants can still participate without a liquid trading hub for delivery to the Ameren-Illinois footprint. If this should be the case, the financial participant could hedge its risk by purchasing the energy products at another hub such as "Into Cinergy" or the PJM NI Hub along with a basis swap.

**Q. What is a basis swap?**

A. A basis swap is a financial product that is readily available in the market. This product values the price difference between two trading hubs.

**Q. Have financial participants been successful in winning load in the New Jersey auctions?**

A. Yes, they have. Past winners in the New Jersey auctions include Morgan Stanley Capital Group Inc. and Select Energy, Inc. Both of these companies have been successful despite not owning any generating assets in PJM.

## ILLINOIS COMMERCE COMMISSION POST 2006 INITIATIVE

**Q. Have you reviewed the report that the Staff submitted to the Commission of the Post 2006 Initiative?**

A. Yes, I have.

**Q. Please summarize the Staff's recommendations as they pertain to procurement.**

A. The Staff, in its report on the Post 2006 Initiative, grouped 18 desirable characteristics of a procurement methodology into categories comprising of five overarching policy goals of the post 2006 procurement process: (1) mitigation of market structure problems, (2) provision of regulatory certainty, (3) provision of market based rates and rate stability, (4) provision of a means to convert results into traditional rate design, and (5) provision of a working procurement option by January 2007.

The Staff also recommends that while the Commission should remain open to more than one procurement plan, that a New Jersey Style Vertical Tranche Auction should be encouraged for the large Illinois utilities that do not own significant generation resources. In addition, the ICC Staff makes the following recommendations:

- The Commission should clarify its authority to implement the use of any given procurement methodology, in general, and a vertical tranche auction, in particular.

- Illinois policymakers should continue to work to ensure that the PJM and the MISO LMP and FTR markets are fully functional and completely resource non-discriminatory before the end of 2006.

- Illinois policymakers should continue to work to ensure that market "seams" between MISO and PJM are eliminated.

- Illinois policymakers should work to ensure that there exists regional markets for ancillary services and capacity within and between MISO and PJM.

- Illinois policymakers should work to ensure that the winners of a vertical tranche supply auction are given LSE status for purposes of PJM and MISO tariffs.

- Illinois policymakers should work to ensure that auction winners can receive annual FTR allocations from MISO and PJM.

**Q. Do you agree with the ICC Staff's recommendation that large Illinois utilities that do not own significant generation resources use a vertical tranche auction?**

A. Yes. As the ICC Staff states in its report, vertical tranche auctions provide a viable means of achieving the five overarching goals for a preferred procurement methodology. A vertical tranche auction is highly transparent, will encourage a wide range of potential suppliers, and will result in competitively priced, market based rates. In addition, the use of a vertical tranche auction as proposed by the Ameren Companies will provide end use customers with relatively stable rates while preserving their right to choose their retail supplier if they so desire.

**Q. The Staff also recommends that Illinois policymakers continue to work to ensure that MISO and PJM have LMP, FTR, capacity and ancillary services**

**markets in place before the end of 2006 and that the seams between these two RTOs be eliminated. Do you agree with this recommendation as well?**

A. Yes, I do. The elimination of seams and the existence of each of these four wholesale market components will maximize the efficiency of an auction. But, I must clarify that of these four wholesale market components only the existence of real-time and day-ahead energy markets is absolutely necessary for a vertical tranche auction to be successful. These energy markets are the foundation on which non-traditional suppliers rely to participate in the auction. Non-traditional suppliers already have the ability in today's wholesale market to purchase capacity bilaterally and ancillary services will be provided by the utilities.

An auction can take place and be successful without the existence of RTO-operated capacity and ancillary services markets. With that said, it should continue to be our goal to maximize the efficiency of the auction process and that requires both the policy makers and the utilities working with the MISO to ensure that capacity and ancillary services markets are in place as soon as possible. As I noted earlier, the MISO is currently projecting the startup of its LMP and FTR markets on April 1, 2005, its capacity markets in 2006 and its ancillary services markets in 2007. The Ameren Companies are committed to continue working with the MISO to ensure that these targets are achieved.

**Q. Finally, Staff recommended that Illinois policymakers should work to ensure that auction winners be given LSE status and that they receive annual FTR allocations from the MISO and PJM. Do you agree?**

A. While I agree that those suppliers who win tranches of load in the auction should be allowed to directly nominate and receive FTRs and ARRs from MISO, I disagree that they should be designated the LSE in MISO. As discussed in detail in the direct testimony of Mr. Nelson, we strongly believe that the distribution utility should remain the LSE. Retaining the distribution utility as the LSE not only makes it clear that the transaction between the winning supplier and the distribution utility is a wholesale transaction (rather than a retail transaction), it also makes it clear that the distribution utility remains the provider of last resort for the load. It is important to note that under the MISO tariff, it is possible for the distribution utility to remain the LSE and the winning suppliers to directly nominate and receive FTRs from the MISO.

**Q. Does this conclude your direct testimony?**

A. Yes, it does.